INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented and statutes involved	2
Statement	2
Argument	3
Conclusion	11

CITATIONS

Cases:	
American Viscose Corporation v. *Commissioner*, 56 F. (2d) 1033, certiorari denied, 287 U.S. 615	4, 7
Helvering v. *Stockholms Enskilda Bank*, No. 10, October Term, 1934	3
United States Trust Co. of New York v. *Anderson*, 65 F. (2d) 575, certiorari denied, 290 U.S. 683	4, 7
Statutes:	
Revenue Act of 1921, c. 136, 42 Stat. 227:	
Sec. 213 (b) (4)	5
Revenue Act of 1924, c. 234, 43 Stat. 253:	
Sec. 1019 (U.S.C., Title 26, Sec. 153)	2
Revenue Act of 1926, c. 27, 44 Stat. 9:	
Sec. 213 (U.S.C.App., Title 26, Sec. 954)	3
Sec. 217 (U.S.C.App., Title 26, Sec. 958)	3
Sec. 233 (U.S.C.App., Title 26, Sec. 985)	7
Sec. 236 (U.S.C.App., Title 26, Sec. 988)	6
Sec. 1116 (U.S.C.App., Title 26, Sec. 153)	2
Treasury Regulations 62, Art. 77	5

In the Supreme Court of the United States

OCTOBER TERM, 1934

No. 24

BRITISH-AMERICAN TOBACCO COMPANY, LTD., petitioner

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinions of the Board of Tax Appeals (R. 15–24) are reported in 27 B.T.A. 226. The opinion of the Circuit Court of Appeals (R. 32–38) is reported in 69 F. (2d) 528.

JURISDICTION

The judgment below was entered March 12, 1934 (R. 38). The petition for a writ of certiorari was filed April 23, 1934, and was granted May 7, 1934

(R. 39). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED AND STATUTES INVOLVED

The question presented and the statutes involved are the same as those in *Helvering* v. *Stockholms Enskilda Bank,* No. 10, October Term, 1934, except that in this case one payment of interest was made during 1925, pursuant to Section 1019 of the Revenue Act of 1924, c. 234, 43 Stat. 253, 346, which section is substantially the same as Section 1116 (a) of the Revenue Act of 1926, involved in the *Stockholms Enskilda Bank* case.

STATEMENT

During the years 1925 and 1926 the petitioner, a foreign corporation with offices in New York City, received from the United States $132,407.17 and $1,394,357.64, respectively, as interest on overpayments of Federal income and excess-profits taxes. In its income-tax returns for those years the petitioner reported the money so received as nontaxable income. The Commissioner held that it was taxable and determined deficiencies accordingly (R. 11–12, 15). An appeal was taken to the Board of Tax Appeals (R. 3–5), where, pursuant to its previous decision in the *Stockholms Enskilda Bank* case, 25 B.T.A. 1328, the Board reversed the action of the Commissioner (R. 15–16). The Commissioner appealed to the Circuit Court of Appeals for the Sec-

ond Circuit (R. 25–28), where the action of the Commissioner was sustained and the decision of the Board of Tax Appeals reversed (R. 32–38).

ARGUMENT

The question presented in this case is the same as that covered in our brief in *Helvering* v. *Stockholms Enskilda Bank*, No. 10, October Term, 1934, and the argument presented there is incorporated here by reference.

Since the preparation of that brief the Government has, however, received the brief of the petitioner in the instant case, and it may be of assistance to discuss at some length the following contentions urged by the petitioner therein:

1. The petitioner contends that if the word "obligations", as used in Section 217(a)(1) of the Revenue Act of 1926, is so construed as to make the interest on the tax refunds taxable, the same meaning must be given the word in Section 213 (b)(4) and that the interest is in consequence expressly exempted from taxation by this latter section (Br. pp. 28–29).

Section 213(b)(4) provides:

> (b) The term "gross income" does not include the following items, which shall be exempt from taxation under this title:
>
> * * * * *
>
> (4) Interest upon (A) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia;

> or (B) securities issued under the provisions of the Federal Farm Loan Act, or under the provisions of such Act as amended; or (C) the obligations of the United States or its possessions. Every person owning any of the obligations or securities enumerated in clause (A), (B), or (C) shall, in the return required by this title, submit a statement showing the number and amount of such obligations and securities owned by him and the income received therefrom, in such form and with such information as the Commissioner may require. In the case of obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit), the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt to the taxpayer from income taxes;
>
> * * * * *
>
> (U.S.C.App., Title 26, Sec. 954.)

As stated in the Government's brief in the *Stockholms Bank* case (p. 26), it was held by the Circuit Court of Appeals for the Third Circuit in the case of *American Viscose Corporation* v. *Commissioner,* 56 F. (2d) 1033, certiorari denied, 287 U.S. 615, and by the court below in the case of *United States Trust Co. of New York* v. *Anderson,* 65 F. (2d) 575, certiorari denied, 290 U.S. 683, that this section referred only to obligations incurred in the borrow-

ing of money, the purpose of the exemption being, as was said in the *American Viscose* case, "to aid in the flotation of government bonds and securities by making them tax free, and, therefore, more attractive to investors."

But the petitioner contends that the interpretation given the section in these decisions is too narrow, and it cites Article 77 of Treasury Regulations 62 in support of its conclusion that the section is broad enough to include the obligation of the United States to refund taxes illegally collected, although such obligation is obviously not incurred in connection with the borrowing of money. (Br. p. 29.) The petitioner says that this regulation constitutes, in effect, a controlling expression of the legislative will because this regulation, adopted in 1922, was in force when Section 213 was reenacted in 1924 and 1926 (Br. pp. 15–16). The regulation provides that—

> ART. 77. INTEREST UPON UNITED STATES OBLIGATIONS. * * * Interest credited to postal savings accounts upon moneys deposited in postal savings banks is exempt from income tax, * * * (Art. 77, Reg. 62).

We submit that the petitioner's contention is not sound for two reasons:

(a) It overlooks the fact that in the 1921 Act (Revenue Act of 1921, c. 136, 42 Stat. 227), enacted November 3, 1921, postal savings certificates of deposit were specifically characterized in Section 213(b)(4) as "obligations of the United States",

just as was done in the later Revenue Acts of 1924 and 1926. After providing that gross income should not include interest upon "(c) the obligations of the United States", the section states that "In the case of obligations of the United States issued after September 1, 1917 (*other than postal-savings certificates of deposit*), * * * the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof * * *." (Italics ours.) It is evident, therefore, that Article 77 of Treasury Regulations 62 is nothing more than a paraphrase of the statute which was in force when the regulation was adopted and was not intended to be an administrative interpretation of statutory provisions of indefinite or uncertain meaning.

(b) Moreover, it would seem to be too clear for argument that postal savings certificates of deposit are, like Government bonds and Government notes, obligations of the United States incurred in connection with the borrowing of money, and that, consequently, this section was not in any wise broadened by its reference to these certificates as obligations coming within the purview of the section.

2. Petitioner also contends that in any event the interest on the tax refunds is exempt under Section 236 (a), which provides that—

> For the purpose only of the tax imposed by section 230 there shall be allowed the following credits:

> (a) The amount received as interest upon obligations of the United States which is included in gross income under section 233; * * * (U.S.C. App., Title 26, Sec. 988.)

Section 233 provides that—

> (a) In the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in sections 213 and 217, except that mutual marine insurance companies shall include in gross income the gross premiums collected and received by them less amounts paid for reinsurance.
>
> (b) In the case of a foreign corporation, gross income means only gross income from sources within the United States, determined (except in the case of insurance companies subject to the tax imposed by sections 243 or 246) in the manner provided in section 217. (U.S.C.App., Title 26, Sec. 985.)

The position of the petitioner is that Section 236 (a) covers all obligations of the United States the interest on which is included in gross income, regardless of whether the interest is included in the gross income of a foreign corporation by reason of Section 217 (a) (1) or in the gross income of a domestic corporation by reason of the general definition of gross income included in Section 213 (a). And he argues that the decision in the *American*

Viscose case was wrongly decided in that it failed to give effect to the provisions of Section 236 (a).[1]

This contention is, we submit, refuted by the legislative history of Section 236(a). As was said by the court below, in reviewing the legislative history (R. 37–38):

> A review of the history of section 236 of the Revenue Act of 1926, c. 27 (44 Stat. 43 [26 U.S.C.A. § 988]), here considered, discloses that it was enacted and reenacted as a part of section 213 (26 U.S.C.A. § 954), and that at no time has it been considered or treated as part of section 217 (26 U.S.C.A. § 958). It had its origin in the Revenue Act of 1918, c. 18 (40 Stat. 1057). As to individuals, section 210 (page 1052) imposed a normal tax and section 211 imposed a surtax, while section 230 (page 1075) imposed a normal tax and section 301 (page 1088) imposed a war and excess-profits tax upon corporations. Section 213 (40 Stat. 1065) defined the gross income of individuals and section 233 (page 1077) made section 213 applicable to corporations. Subdivision b of section 213 (40 Stat. 1065), it will be observed, does not exclude from gross income interest upon all obligations of the United States incurred in the borrowing of moneys. Relating to the tax upon individuals, section

[1] In this case it was held, as has been stated, that the exemption provisions of Section 213 (b) (4), quoted above, (*supra*, pp. 3–4), related only to obligations of the United States incurred in the borrowing of money.

216 (page 1069) provided that for the purpose of normal tax only there should be allowed credits (b) "The amount received as interest upon obligations of the United States * * * which is included in gross income under section 213." Section 236 (page 1080) contained a similar provision with respect to normal tax upon corporations. Thus there was exempted by Congress, both as to individuals and corporations, from the normal tax, all interest received from obligations of the United States incurred in the borrowing of money, but it made a certain class thereof subject to surtax and war and profit taxes. War and profit taxes were carried forward in the Revenue Act of 1921, § 301, c. 136 (42 Stat. 272), for the year 1921 only, and sections 213, 216, and 236 (42 Stat. 237, 242, 257) were carried forward without substantial change. The war and excess-profits tax was in effect for the year 1921 and no longer. The provisions of sections 213, 216, and 236 were without limitation and were subsequently carried forward into the Revenue Act of 1924, c. 234 (43 Stat. 253), and 1926 (26 U.S.C.A. §§ 954, 958 and notes, 988). So far as corporations are concerned, sections 213, 233, and 217 of the 1924 and 1926 acts (26 U.S.C.A. §§ 954, and note 985, 958, 958 and note) includes in "gross income" interest upon certain of the bonds of the United States issued in the borrowing of money, and section 236 takes it out. Congress, we

> think, used the word "obligations" in section 236 in reference to those obligations the interest upon which it specifically included in gross income.

Whether Congress intentionally continued the provisions of Section 236 (a) beyond the expiration of the war and excess-profits tax provisions of the Revenue Acts of 1918 and 1921, or whether its continuance was an oversight, is not clear, but it is, we submit, manifest from the legislative history of the section that Congress intended by its provisions to exempt from taxation only the interest upon those obligations of the United States incurred in connection with the borrowing of money which it had specifically included in gross income under Section 213 (b) (4). Section 236 (a), as its history shows, has always been considered as a counterpart of Section 213 (b) (4) and as relating only to the particular type of obligations of the United States therein referred to. It has never been treated as having any relation to Section 217. We therefore submit that the petitioner's contention is without merit.

CONCLUSION

The decision below is correct and should be affirmed.

Respectfully submitted.

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